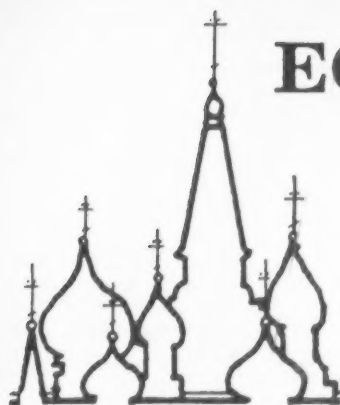


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ECONOMIC NEWSLETTER

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No Report for the First 11 Months of 1988

As has happened twice before in 1988, the Soviet Union did not publish the economic results for November in its general press. While the publication of these figures is a long-standing tradition, and the government continues to publish quarterly figures, the authorities apparently have restricted this data for 1988 to the publications of the State Committee for Statistics, the official statistical organization of the Soviet Union. In years past when these figures disappeared, it was usually because they were not satisfactory. There is some reason to believe this is the case at the present time. It is perhaps significant that they have not released estimates of the grain harvest, figures which are usually reported at the very latest by November of the harvest year. We know from various sources that the harvest will be at least 30 million tons below expectations and conceivably more.

While the formal All-Union report is not available to date, there is some information to be found about economic developments in the country. There is a general report of economic results for the month of November in the Russian republic (RSFSR), the largest of the Soviet republics. These statistics, which presumably indicate similar trends for the country as a whole, are rather disappointing. While they show that national income has increased by 4% during the first eleven months of 1988 when compared to 1987, the official report also says "On the whole our performance was better than last year's, but appreciably poorer than planned."

What seems of particular concern is that some of the main industries in the Soviet Union are encountering serious difficulties. For example, the official report indicates that the machine tool industry in the Russian republic is "particularly strained." One out of two enterprises has incurred a debt. At a time when enterprises are being told they must meet their debt obligations or go bankrupt, this could have serious implications. There

are similar difficulties, although not of the same magnitude, in the coal and timber industries.

While many of these problems are in the heavy industrial sector, it appears that there are even more serious problems in the consumer sector, problems which are a direct reflection and consequence of the difficulties in the industrial sector. There seems to be a growing disproportion between increases in income and increases in the availability of goods. Inevitably this means an unanticipated increase in savings, and growing inflationary pressure. The official report for the RSFSR indicates that monetary incomes in the Russian republic rose over nine percent during the first eleven months of 1988, compared to the same period in 1987, but this was double the planned rate. At the same time, expenditures for the purchase of goods rose seven percent, one percent below what was anticipated. This leads to shortages of goods. As the report indicates, one-third of the meat sold in the Russian republic is sold on a coupon rationing system. Moreover, potato and vegetable supplies are lower than they were last year and sales of these products are nineteen percent below the plan. The report also indicates that other consumer goods are in short supply and indeed, in shorter supply than had been the case in previous months. According to the report, "it is difficult to buy consumer goods and tape recorders, and almost impossible to buy video equipment. Refrigerators and washing machines seem to have vanished."

The suggestion is that some of these goods are now being exported as enterprises are being allowed to keep a percentage of the foreign export proceeds they earn from exported goods. Inevitably domestic prices have begun to increase and it is stated in the report that textile prices have risen six to eight percent and leather footwear by fifteen percent. On top of everything else, apartment construction, which had increased rapidly in 1986 and 1987, was about 3% lower in 1988 and only two-thirds of the planned target.

It is not surprising, therefore, that we read reports of a run on gold and other jewelry supplies. For months the Soviets have been talking about price reform and articles recently have begun to appear warning that this discussion could create minor panics. The authors of these articles are concerned that pressures will grow as

people begin to see the price reform taking shape. Even though the wholesale price reform is not due to begin until January 1990, the proposed fees are being published and consumers assume that this will mean either an increase in retail prices or an increasing subsidization of prices, which would, of course, increase the size of the national budget deficit. It is being reported that wholesale electric prices for coal will rise ninety percent as of the first of next year. As a result, agricultural consumers will face a three-fold increase in electricity costs. Under these circumstances, people traditionally begin to hoard real goods and if they cannot find jewelry, they will buy appliances.

The implications of the price reform process for the Soviet Union are very serious. Because Mikhail Gorbachev has insisted that the price reform will not lead to an increase in prices for consumers, the only way to achieve this is to provide subsidies between the wholesale and retail levels. But as noted earlier, this ultimately means that there will have to be an increase in the budget deficit. This, of course, adds to inflationary pressure. It is not a happy situation and accounts as much as anything for the very sharp decline of public opinion in support of the process of economic *perestroika*.

Arden House to be held March 31 - April 2

The program for the thirteenth annual Arden House Conference on American-Soviet Relations is now in the final stages of completion. Organized in a series of panel discussions, this year's conference will focus on the impact of a new American administration on various aspects of Soviet-American relations. Topics this year include a look at internal political restructuring, the impact of *perestroika* and *glasnost* on Soviet foreign policy developments, and economic reform, all important issues deserving serious attention. The Soviet foreign trade outlook will be assessed by representatives from Western nations, including the United States, Federal Republic of Germany, and Great Britain.

Our congressional panel now includes Congressman Peter Smith (Republican from Vermont) and Senator John Heinz (Republican from Pennsylvania). Senator Heinz's attendance at this point is tentative subject to the demands of his office. A special panel of representatives of the new Bush administration will provide us with some insight into the policy objectives of the next administration. Thus far we have high level speakers from the Departments of Defense, State, and Commerce. The final panel on Sunday will feature representatives of American companies operating in the Soviet Union, with Moscow representatives from General Electric, Wang

Computers, and Combustion Engineering.

We are very pleased to announce that the Honorable Jack Matlock, U.S. ambassador to the U.S.S.R., has indicated he will be able to attend again this year and will help us put the issues under consideration into a framework of overall Soviet-American relations under a new administration.

The final program will be mailed out as soon as we hear from one or two more members of the U.S. Congress. In the meantime, we have enclosed an application form with this newsletter for those subscribers who want to register early to assure themselves of a reservation.

Corporate Sponsor Seminar: "Soviet Agriculture: The Impact of Reform"

The program for our conference on Soviet agriculture is enclosed with this newsletter. Because the topic of agriculture is such an important one, we are making a special effort to bring over Soviet speakers to discuss the reform process and the results thus far achieved. Vladimir Tikhonov, an outstanding writer on agriculture and a member of the All-Union V.I. Lenin Academy of Agricultural Sciences, has indicated that he is eager to come. Alexander Shakai, of the Institute for Foreign Economic Relations of the Soviet Union, has also indicated that he would like to accept our invitation to appear. Needless to say, the participation of both is subject to their receipt of visas, but we are quite hopeful they will be able to participate. We also have a tentative agreement to speak from the Soviet agricultural attaché in Washington, Dr. Nikolai G. Pervov.

In addition to an examination of the reforms as they exist on paper, Dr. Tikhonov and Mr. Fred Crook of the U.S. Department of Agriculture will look at the reform process in action, in case studies of the Soviet Union and China. Marshall Goldman will then compare the two systems and suggest lessons to be learned.

Export prospects will be discussed by Mr. Karl-Hugo Schlunk, the president of Alfred C. Toepfer International, Dr. Shakai, and Mr. John Kingery, the Associate General Counsel of the Office of the U.S. Trade Representative. Mr. Kingery was the chief U.S. negotiator in the most recent Soviet-American grain sales.

The final panel will examine joint ventures and other activities in the food processing and chemical industries and will feature Mr. Perry Dixon, Director of Economic Research for Archer Daniels Midland, and Mr. Nha Hoang, Director, International of the FMC Corporation.

An application form and final program are enclosed.

USSR Foreign Exchange Quotations

Currency	14 Sept	12 Oct	9 Nov	14 Dec
£100 Sterling	106.05	106.77	108.12	110.59
100 Aust. sch.	4.80	4.80	4.86	4.90
\$100 US	62.58	62.54	60.86	60.00
100 Fr. Francs	9.94	9.89	10.00	10.08
1,000¥ Japanese	4.69	4.72	4.88	4.88
10,000 Italian Lire	4.52	4.51	4.59	4.67
100 Swiss Francs	40.06	39.72	40.77	40.92
100 Deutsche Marks	33.81	33.73	34.20	34.47

Gorbachev Gambles That Success Is Measured in Plumbing, Not Missiles

By MARSHALL I. GOLDMAN

What a Christmas present: Swords into plowshares, tanks into tractors, missiles into microcomputers, planes into plumbing.

Mikhail S. Gorbachev had something for almost everyone last week in New York. In a single speech, Gorbachev sought to solve what appeared to be the near-intractable dispute between East and West while at the same time offering some needed support for *perestroika* and his effort to revitalize the Soviet Union's economy. Others have discussed extensively the international effect. But the internal implications in some ways may be equally far-reaching.

From the day he assumed the post of general secretary in March, 1985, Gorbachev's obsessive concern has been to revitalize his country's economy. Almost everything else is designed in some way or another to facilitate the realization of that goal. Thus, whatever their intrinsic merits, *glasnost* and democratization are intended to win popular support for his economic-reform effort. By calling for criticism of waste, incompetence and corruption, Gorbachev hopes to show Soviet workers that society will not tolerate the type of favoritism and elitism that characterized so much of the Brezhnev era.

By reaching out to the United States and President Reagan, Gorbachev has sought to bring about the relaxation of tensions so that he can proceed to divert resources from the military sector. He realizes that as long as society spends upwards of 15% of its gross national product on military

expenditures, it will be unable to satisfy the needs of its population for consumer goods. After a time, that is likely to lead to a decline in morale and an unwillingness to work. The result is sure to be economic deterioration and stagnation.

While the progress made in reaching a treaty on intermediate-range nuclear forces brought about an astonishing change in the international climate, those of us on the outside kept asking for some tangible sign that the new environment would produce a Soviet switch from guns to butter.

That is why Gorbachev's blockbuster announcement of a unilateral cut of 500,000 Soviet troops was so ingenious. Such a large contraction should be able to provide doubters in the West with concrete evidence that his desire to reduce Soviet forces is real.

Gorbachev's new program should also bring him important benefits at home. The Soviet people already know, as one of the country's leading economic analysts reported in late October, that their real standard of living has dropped for the last two years. Now Gorbachev has promised that in the next year two or three weapons-producing factories will be converted to the production of civilian goods. Soviet officials have already promised that 40% of the plumbing that they plan to install in new housing over the next seven years will be made by factories that heretofore have been producing weapons. Similarly, the Medium Machine Building Ministry, the Soviet Union's prime defense contractor, has announced that it will assume responsibility for producing a new type of dairy-processing equipment. Such products go

to the heart of the needs of the people.

If he can pull it off, the potential benefits should win favor for Gorbachev's efforts and additional time for him to show that his program can produce actual results.

But Gorbachev is savvy enough to know that unilateral action of this sort also comes at a cost. Just because he orders military factories to produce consumer goods does not mean that they will do it, particularly if it means that the managers and workers will have to work harder and take on new and unaccustomed risks. Nor does it mean that the quality of the new products will necessarily be an improvement over the existing output. Nor will new products alone be enough. The Soviet Union also needs an expanded infrastructure. Thus, if automobile output is expanded, at some point the Soviets also will have to increase highway construction, at present only 15% of ours.

There is a second risk that Gorbachev will also have to encounter: the many generals who are distressed by what they see as his willingness to disarm the Soviet Union. That, more than his poor health, must explain why Marshal Sergei Akhromeyev, the chief of staff of the armed forces, decided to resign at the same time that Gorbachev made his initiative public.

Equally haunting is the fact that Gorbachev is not the first Soviet leader to take on the Soviet military-industrial complex. Nikita S. Khrushchev also announced a large-scale demobilization of the military. By doing so he lost the support of the generals and, eventually, his job.

That Gorbachev should nonetheless move as he has done suggests not only that he is a bold leader but also that he is willing to gamble that he needs popular support more than military support, and plumbing more than missiles.

Los Angeles Times

Tuesday, December 13, 1988

THE SOVIET UNION

The ruble as barrier to Soviet free trade

Gorbachev hopes to deal USSR into global market

By Marshall I. Goldman

Soviet President Mikhail Gorbachev's goal of making the Soviet Union more competitive in the world — and especially in the American market — will not be easily accomplished. But after some delay, he at least seems to be heading in the right direction. Abandoning many sacred dogmas from the past, the Soviet Union announced that all Soviet enterprises beginning in April will be able to engage in exporting and importing. Heretofore, trade was a monopoly of the Ministry of Foreign Trade even though more recently it was extended to approximately 100 large enterprises and ministries.

In an equally far reaching step, Soviet authorities announced that foreign businessmen henceforth will be allowed to hold unlimited ownership in joint ventures or subsidiaries they establish in the Soviet Union. The Soviets have also declared that they will establish a special economic zone for foreign business operations. The zone will be in the Soviet Far East along the Pacific coast. As in China, joint ventures set up in the Soviet special economic zone will have a tax free holiday during the first three years of oper-

ation and lower rates of taxation thereafter.

To appreciate how radical these measures are, we should remember that, for nearly 60 years, the Soviets have boasted of how they created a state monopoly in foreign trade and banned all foreign exploitation of Soviet workers. With these changes, they have acknowledged that this monopoly and isolation have been counterproductive.

One of Gorbachev's main goals today is to bring Soviet industry up to world standards. Encouraging Soviet enterprises to export or import is one way to accomplish this, as is the decision to reduce the role of central planning, heretofore another cherished Soviet practice. But Gorbachev and his advisers realize that diminishing the role of central planning and authorizing Soviet enterprises to import and export for themselves will be empty gestures unless the Soviet ruble becomes convertible. As of now, it is illegal to take rubles in or out of the Soviet Union, and the Soviet government closely regulates the rate of exchange of rubles for hard currency. No wonder that so far only about a hundred foreign businessmen have been willing to set up joint ventures in the Soviet Union. What can they do with the rubles they earn, especially if they are unable to buy much with those rubles inside the Soviet Union itself? Therefore, if they are to attract more businesses, sooner or later the Soviets will have to make the ruble convertible and, given their recent announcement, it is clear that Gorbachev is trying to make it sooner.

Recognizing their dilemma, the Soviets have announced that they plan to facilitate the conversion of rubles into Western and Japanese currencies. But this will not happen overnight. Convertibility will only occur when enough foreigners decide they want the ruble because they find it advantageous to buy Soviet products. True, there are some now who want to buy Soviet goods, especially oil and natural gas, but not enough to offset the many more inside the Soviet Union who would like to buy foreign goods.

This lack of interest in buying Soviet



Soviet leader Mikhail Gorbachev

goods shows up dramatically in the trade statistics. For example, machinery accounts for only 2 percent of what West Germany, the Soviet major noncommunist trading partner, buys from the Soviet Union, while oil and natural gas constitute 80 percent of the total. And Soviet machinery imports to the United States were also only 2 percent of our total purchases from the Soviets.

There are several ways to make Sovi-

et produced products more desirable. One way is to improve their quality. That is one of the purposes of Gorbachev's domestic reforms we have come to call *perestroika*. Another way is to reduce the price of what is being sold. That would mean making rubles more readily available to foreigners and at a cheaper price. To accomplish that, the Soviets have declared that, within a year, the ruble's declared value, in terms of the dollar, would be cut in half, and by even more than that in two years. In effect, the Soviets are planning to devalue the ruble. To sustain the process and make it meaningful, however, they have also decided to establish an ongoing exchange market where those who want rubles can bargain with those with rubles to sell. For the time being, at least, all this will be supervised by the banking authorities. But the creation of such an exchange is a prerequisite for making this an ongoing process and providing for the play of market forces.

Again, such measures constitute an unusually radical departure from past Soviet practice. The Soviets in the past have been especially proud to claim that because the ruble has not been convertible, it has been insulated from fluctuations in the world currency markets. Before the Gorbachev era, most Soviet authorities, as well as some American economists, were insistent that we would never see an increased convertibility of the ruble. Though they may still be right, it does look like Gorbachev is doing his best to prove them wrong.

The move to improve convertibility is an important step in the right direction, but it may not be such good news for some American businessmen. A cheaper ruble is likely to mean fewer purchases of Western equipment by Soviet enterprises. Devaluation always makes foreign products and imports more expensive. At the same time, however, while it should make exports of Soviet made products cheaper and therefore more attractive, it would also mean that profits earned in rubles from such ventures will be less valuable. The beneficiaries of such a move will be importers of Soviet goods, assuming, of course, foreigners are allowed access to these cheaper and presumably convert-

ible rubles. For example, by 1990, Soviet vodka prices should be half what they are now. A devaluation of 50 percent or more is unusually large.

It is unclear whether foreign buyers will be able to take advantage of such cheap rubles. This devaluation may only apply to Soviet holders of rubles. Even so, this suggests that the black market price for rubles on Moscow streets is closer to reality than the official price established by Soviet banks.

While all these policy and ideological reversals are important steps in making Soviet products more competitive, it will still take some time before the internal changes lead to substantial and qualitative changes in most products. In addition, most manufactured goods the Soviets want to sell to the United States are still subject to very high tariffs. Because of past Soviet human rights policies and restrictions on emigration, the US Congress passed the Jackson Vanek Amendment in 1975. This denies Soviet products most favored nation status. As a consequence, importers of most Soviet products must pay tariffs that were passed in the protectionist era of the 1930s.

Given that since Gorbachev came to power the human rights and emigration situation in the Soviet Union has also undergone radical change, it would seem that perhaps the United States should also reconsider its policy regarding the Jackson-Vanek Amendment. There is not much the United States can do to help Gorbachev with his problems at home. It could, however, help in a small way by showing that Gorbachev's policies are appreciated in the outside world. Thus President-elect George Bush, as an introductory gesture, should issue a waiver of the Jackson Vanek Amendment. At best, that would yield only a slight increase in the import of Soviet products, but it would be a sign that we applaud his efforts to bring the Soviet economy into the world economy, and that we also appreciate his human rights policies.

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